

Internal Revenue Service

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Date: April 8, 2009

Legend:

X =

A =

B =

T1 =

T2 =

T3 =

T4 =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Court =

State =

Dear :

This responds to a letter dated November 10, 2008, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on D1. X elected to be an S corporation effective the same date. At the time of the election, T1, a grantor trust, was the sole shareholder of X. On D2, all shares of X stock were transferred to T2, a grantor trust. On D3, A, the grantor of T1 and T2, died.

On D4, X stock held by T2 was allocated equally between T3 and T4. T3 is a trust described under § 1361(c)(2)(A)(i). T4 was intended to be a qualified subchapter S trust (QSST). However, B, the income beneficiary of T4, failed to file a timely QSST election. Furthermore, T4 could not have been a valid QSST because its terms failed to require specifically that (1) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust and (2) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary. Consequently, X's S election terminated on D4.

On D5, the trustee petitioned Court to modify the terms of T4 to qualify to be a QSST. On D6, Court approved the requested modification.

X represents that all relevant times, X and its shareholders treated X as an S corporation. X further represents that the termination of X's S election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under " 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who

is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the QSST which consists of S corporation stock to which an election under § 1361(d)(2) applies. Section 1361(d)(2) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides in part that if (1) an election under ' 1362(a) by any corporation was terminated under ' 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period of inadvertent termination of the S election, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

Rev. Rul. 93-79, 1993-2 C.B. 269, provides that a state court order that reforms a trust to meet the requirements of a QSST is recognized prospectively.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation terminated on D4. We also conclude that the termination was an inadvertent termination within the meaning of ' 1362(f). We further conclude that T4, as modified, meets the definition of a QSST under § 1361(d)(3). Accordingly, under the provisions of ' 1362(f), X will be treated as continuing to be an S corporation from D4, and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under ' 1362(d). X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated computed items of income or loss of X, as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368.

This ruling is conditioned upon the filing of a completed QSST election for T4 effective D6 with the appropriate service center within 60 days of the date of this letter and upon B's being treated as the shareholder with respect to the X stock held by T4 effective D4 and thereafter.

Except as specifically provide herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Under a power of attorney on file in this office, a copy of this letter will be sent to X's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

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